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## Handling Options When Coverage Is In Question

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When dealing with a claim when coverage is disputed, there are a number of options available to an insurer. Unfortunately, there is no magical formula to decide which one is best. Instead, that facts of each case must be weighed and, largely by a process of elimination, a choice made. Presented below are three of the options that are commonly considered.

### Option 1: The Naked Disclaimer

Frequently, if initial analysis of a file indicates that there is no coverage in place, the route taken is to disclaim coverage and to refuse to either provide a defense or to indemnify the insured in the suit that has been or may be brought. This way of proceeding is probably the most perilous because, once coverage is denied, the insured has no obligation to cooperate with the insurer at all. Thus, if the disclaimer is issued before suit is commenced (say, for example, on the basis of late notice), the insured has no obligation to forward the suit papers to the insurer if and when he is served.

Although the insured may initiate a declaratory judgment action against the insurer upon receiving the disclaimer letter (the plaintiff has been found to have no standing to bring such an action until more than 30 days have passed and a judgment remains unsatisfied), that at least will lead to a prompt determination of whether coverage is owed. A more dangerous result can be that the insured does nothing to contest the coverage decision and a judgment is subsequently entered against the insured (either after trial or perhaps even a default or consent judgment).

If the judgment goes unsatisfied for more than 30 days, the plaintiff can then bring a direct action against the insurer. In that action the liability that was found and the amount of damages that were awarded will be binding upon the insurer. The only issue that can then be litigated is the validity of the disclaimer. If the disclaimer is found to have been improper, the insurer is liable to pay the underlying judgment, any applicable interest, plus the counsel fees that the insured incurred in defending the suit. Thus, while this option may be appropriate in certain circumstances, it is a perilous game of Russian Roulette.

### Option 2: Disclaim and Bring A declaratory Judgment Action

Instead of simply walking away from the claim altogether, insurers occasionally deny coverage and immediately start a declaratory judgment action to obtain a determination of whether their decision was valid. The goal with proceeding in this fashion is to obtain a rapid Declaration from the court, and then, if the decision is against the insurer, to assume at least the defense of the insured. The problem with this is that the declaratory

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judgment action may be delayed, or that the court, depending upon the reason for the disclaimer, may not be willing to reach a decision until after the underlying suit is resolved. If this happens, the insurer is essentially in the same position that it would be in if the declaratory judgment action was not brought. Furthermore, again depending upon the ground for the denial, the insurer may not even be allowed to initiate the declaratory judgment action at that point. This can happen when the disclaimer is based upon the applicability of an exclusion and, without the commencement of a suit, there is no summons and complaint against which the court can evaluate the exclusion. Once again, if this happens, the insurer is in no better position than it would have been under Option 1.

### Option 3: Split The Duties

Among the duties that an insurer has are the duty to defend and the duty to indemnify. The separation of these duties frequently manifests itself in cases where the complaint contains covered and non-covered causes of action. In that situation, the insurer agrees to defend the insured, frequently by counsel of its own choice to avoid creating coverage by estoppel (**yes, that can happen**) but denies any obligation to indemnify if liability is imposed on the insured under certain circumstances. This same procedure can be used in different situations.

For example, two years after an incident, an insurer receives first notice of claim, and this notice comes from the attorney who has just been retained to represent the claimant. The investigation into the matter reveals probable, but not certain success, on the basis of late notice. Because Insurance Law 3420 (d) (Preclusion) obligates an insurer to promptly disclaim in writing or lose the late notice ground, the insurer here may very well have to disclaim before a suit is even commenced. Although the disclaimer letter may include the provision that the insured should immediately forward any suit papers that are served so that the insurer can reconsider its decision at that time, I do not believe that the insured is obligated to do so. Thus, the insurer is again facing a situation where it hears nothing about this case again until the plaintiff is seeking to enforce a judgment that has been entered against the insured.

This situation can be avoided by splitting the obligations to defend and indemnify. That is, the disclaimer letter can agree to provide a defense to the insured but deny any obligation to indemnify pending judicial determination of the coverage issue. Although I am not aware of a case that has addressed this option, the insured should be found to have the obligation to cooperate with the insurer. Thus, if the insured does not forward the suit papers to the insurer, the insurer may have another ground to escape any obligation to provide coverage that might otherwise have been imposed upon it. In addition, the insurer may also commence an immediate declaratory judgment action to have the coverage issue resolved.

All of these options obviously bring with them certain costs and risks. The particular facts of the claim have to be reviewed to determine the option that is most appropriate for that particular case. Because it gives the insurer the most amount of protection, it is our suggestion that the insurer start with Option 3 and then determine why it is not the appropriate way to proceed on a case by case basis. That decision, however, is up to you.

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